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In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 348

UNITED STATES CARTRIDGE COMPANY, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES

The United States does not oppose a review of the question of the asserted right to a deduction for obsolescence.

OPINION BELOW

The opinion of the Court of Claims (R. 88) is reported in 48 F. (2d) 983, and also in 71 C. Cls. 575.

JURISDICTION

The judgment sought to be reviewed was entered June 10, 1931. (R. 200.) The petition for certiorari was filed September 3, 1931. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the petitioner, in computing its taxable income for the year 1918, was entitled to a deduction for obsolescence of its interest in certain buildings in excess of the deduction for exhaustion allowed by the Commissioner. The claim of the petitioner is based upon the fact that the value of its interest in these buildings, which it had erected on leased land for the purpose of manufacturing ammunition for war, declined greatly because of the termination of that business after the armistice. The facts relating to this question are stated on pp. 3–5, *infra*.

2. Whether, in computing petitioner's taxable income for the year 1918, the Commissioner erred in the valuation which he placed upon the petitioner's inventory as of December 31, 1918. This question depends upon the proper method of valuing certain material which was being manufactured for the Government. The facts relating to this question are stated on pp. 5–7, *infra*.

STATUTES AND REGULATIONS

The applicable statutes and regulations appear in the Appendix, pp. 16–22, *infra*.

STATEMENT

This suit was brought to recover alleged overpayments of the petitioner's 1918 income and profits taxes amounting to $843,589.12. The petitioner's claim was predicated upon three alleged errors of the Commissioner. (R. 15–43.) The Court of Claims

sustained the contention of the petitioner as to one of the alleged errors and entered judgment for petitioner for $160,978.83 and interest. (R. 200.) No question as to this point is here involved.

Prior to 1914 the petitioner was engaged in the manufacture of ammunition for commercial purposes, its business being carried on largely in rented buildings. (R. 77.) In 1914, for the purpose of filling war orders which it had received and expected to receive, the petitioner began the construction of certain buildings on land of its lessor, under an agreement whereby it was to occupy such buildings, rent free, for ten years, at the end of which term the buildings were to become the property of the lessor. (R. 77–78.) These buildings were erected, largely in 1915 and 1916, at a cost of $802,499.49. (R. 78.)

When the petitioner erected the buildings it had no use for them except for war purposes. During the war the petitioner used them to their full capacity in a large and profitable ammunition business. (R. 78–79.) After the armistice in 1918 the petitioner received no new orders for military ammunition and did not expect any. It had no expectation of continuing the production of military ammunition after the war and did not do so to any material extent. It continued its commercial ammunition business after the war, and as it had more space in its buildings than it needed for that business, it used all of the remaining space in the manufacture of radiators, radiator tubes, motors, paper

boxes, and other articles. (R. 81.) The volume of this other business was small as compared to the petitioner's commercial ammunition business. (R. 81–82.) The petitioner realized no net return from this other business, and it made no profit on its commercial ammunition business during any of the years 1919 to 1924, inclusive. (R. 82.)

After the armistice there was no demand for the new buildings and they could not be rented. Some of these buildings had been incorporated into the old buildings, so that the two groups had to be used as a unit. (R. 81, 86.) During the period from 1914 to 1924 the petitioner was a tenant at will of all the buildings which it occupied, except the new buildings erected in 1914 and 1915. (R. 87.)

From a mechanical point of view there is no difference between the manufacture of military ammunition and commercial ammunition except that the same machinery will produce more military ammunition because there are fewer sizes and types of the former than of the latter. (R. 82.)

In the petitioner's income and profits tax returns for the years 1914 and 1917, inclusive, the Commissioner allowed deductions for exhaustion of the new buildings totaling $197,107.74. (R. 79.) In its 1918 return the petitioner asserted that the value on December 31, 1918, of its right to use the buildings for peace-time purposes for the remainder of the term of ten years was only $190,969.86, and asserted that it was entitled to deduct from its gross income as the loss of useful value for 1918 the difference

between the depreciated value of the buildings at the beginning of 1918 (i. e., the cost, less depreciation to December 31, 1917) and the residual value of the lease, $190,969.86, at the end of 1918. The deduction so claimed amounted to $414,421.89. (R. 79–80.) The Commissioner rejected the claim of the petitioner and allowed a deduction of $86,484.54 for depreciation of the buildings for 1918. The amount of this allowance, as well as the prior allowances totaling $197,107.74, was based upon a rate so calculated that at the expiration of the lease the cost of each building would be extinguished by equal annual installments. (R. 80.)

The value of the petitioner's right to use the new buildings for the six years of its lease remaining after December 31, 1918, did not exceed $190,969.86. (R. 82.) In its tax returns for the years 1919 to 1924, inclusive, the petitioner claimed deductions on account of the cost of the buildings aggregating $190,969.86—this amount being allocated proportionately over those years. The Commissioner increased the deductions for these years by $327,937.35, the amount of the deduction which the Commissioner had disallowed for 1918. (R. 80.)

During 1918 the petitioner was engaged in manufacturing ammunition under four contracts with the United States. One of these contracts was made in 1917 and all the others on various dates in 1918 prior to November 11, 1918. (R. 67–68.)

One of these contracts was supplemented by an agreement made December 18, 1918, which was not executed in compliance with the statutory requirements. (R. 132–134.) This was, however, validated by the Dent Act, which was approved on March 2, 1919 (40 Stat. 1272). Each of the contracts contained a provision for cancellation by the Government in the event of the end of the war, and provided that in the event of the termination of the contract the Government would reimburse the petitioner for the cost of worked and unworked materials then on hand. (R. 126, 142, 154, 170.)

In December, 1918, the Government notified the petitioner to suspend production under these contracts, each notice stating that the request was made with a view of negotiating a supplemental contract providing for the cancellation, settlement, and adjustment of the existing contract in a manner which would permit of a more prompt settlement of payment than would be practicable under the existing contract. (R. 69.) Pursuant to these notices the petitioner suspended production under the contracts. (R. 70.) Negotiations for the execution of "settlement contracts" were begun early in 1919 and were continued until 1922. Under final settlement contracts entered into in 1920, 1921, and 1922, the petitioner was paid a total sum of $1,154,618.35 by the United States. (R. 75.)

The fair market value of the worked and unworked materials which the petitioner had on hand on December 31, 1918, applicable to the contracts

here involved, without considering any special value arising from obligations of the United States, was $231,615.43. (R. 76.) The value of these materials on that date, pricing at cost those which were subsequently taken over at cost by the United States, pricing the materials for which the petitioner was paid a part of the cost at the amount which was received therefor under the settlement contracts, and pricing the remainder at the fair market value on December 31, 1918, was $732,088.62. (R. 76.) In valuing the petitioner's inventory at the end of 1918 for the purpose of determining the petitioner's 1918 taxes, the Commissioner valued the materials in question at $732,088.62 (R. 76) and rejected the petitioner's contention that they should have been valued at $231,615.43 (R. 77). Any reduction in the inventory below $732,088.62 would cause an equal reduction in the petitioner's taxable income for 1918. (R. 77.) The petitioner kept its accounts and made its returns upon the basis of the calendar year and upon the accrual basis. (R. 59.)

The Court of Claims held that the Commissioner did not err either in fixing the allowance for exhaustion of the leased buildings or in the computation of the petitioner's inventory. (R. 96–110.)

DISCUSSION

I

The first question involves what seems to be a novel point under the provisions of the revenue acts providing for "a reasonable allowance for

obsolescence." The petitioner contends that the decision below conflicts with that of this Court in *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648. Without conceding this, we consider that the question whether the principles there enunciated apply to this case is one of sufficient doubt and importance to justify a review by this Court.

If a review is granted, we assume that it will include all questions as to allowances in connection with all of the buildings, including the garage mentioned in Paragraph 56 of the findings. (R. 83.)

II

We suggest that if the writ is granted, review be limited to the question of the allowance for obsolescence claimed by the petitioner, as the other contentions of the petitioner do not seem to us to raise questions worthy of consideration by this Court. The ultimate question raised by these contentions is whether the Commissioner's valuation of the petitioner's inventory as of December 31, 1918, was justified. The petitioner contends that the value should have been fixed at $231,615.43, which the Court of Claims found was "the fair market value of said materials and work in process on December 31, 1918, without taking into consideration any special value of such goods to the plaintiff arising from said contracts [with the Government], if any such special value existed." (R. 76, Par. 41.) The Commissioner's figure, $732,088.62, included

the cost of certain materials for which the Government reimbursed petitioner as the result of settlements arising out of the obligation of the Government to pay such costs upon termination of the contracts.

Section 203 of the Revenue Act of 1918, p. 16, *infra*, provided that when—

> the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

The statute went no further than this.

The regulations promulgated under the Act recognized as a basis of valuation which meets the requirements of the Revenue Act that of "cost or market, whichever is lower." (See Article 1582, as amended, p. 21, *infra*.) The petitioner contends that it was entitled to have its inventory taken on the basis of market value. The court below held that, even if the inventory were taken upon this basis, it would have to be taken subject to the exception in Article 1584 (p. 21, *infra*), which provided that even where the inventory was taken on the basis of "market,"

> goods on hand or in process of manufacture for delivery upon firm sales contracts

> * * * at fixed prices entered into before the date of the inventory * * * must be inventoried at cost.

The court below held that the goods in question were "goods in process of manufacture for delivery upon firm sales contracts at fixed prices", and accordingly held that they were properly inventoried at cost. It based this conclusion upon the fact that each contract between the petitioner and the United States provided, in substance, that in the event of the termination of the war—

> The Chief of Ordnance may * * * notify the Contractor that any part or parts of the articles then remaining undelivered shall not be manufactured or delivered. (R. 125–126, 141, 153, 170.)

and further provided that—

> In event of such complete or partial termination the United States * * * shall pay to the Contractor * * * the cost of materials * * * then on hand in an amount not exceeding the requirements for the completion of this contract. (R. 126, 141–142, 153–154, 170.)

whereupon—

> Title to all such materials and component parts paid for by the United States * * * shall * * * vest in the United States. (R. 126, 142, 154, 170.)

In December, 1918, the Ordnance Department sent the petitioner a notice under each contract requesting the petitioner immediately to suspend

further production, and stating that the request was made with a view to negotiation of a supplemental contract providing for the cancellation, settlement, and adjustment of the existing contract in a manner which would permit of a more prompt settlement and payment than would be practicable under the existing contract. (R. 69.) Pursuant to such notices the petitioner suspended further production under the contracts. (R. 69–70.) By virtue of the notices to suspend production there came into being, prior to December 31, 1918, an obligation on the part of the United States to pay the petitioner the cost of materials then on hand.

The petitioner contends that the contracts were not *cancelled* but merely *suspended,* and that, therefore, the United States did not become liable to pay the cost of the materials until the execution of the final settlement contracts in subsequent years. But reference to the terms of the contracts above quoted will show that the Chief of Ordnance was authorized upon the ending of the war to notify the contractor not to manufacture or deliver any further munitions, and that upon the event of a complete or partial "termination" of manufacture the United States should be liable for the cost of the materials. The Government's obligation under these provisions was not dependent upon a technical cancellation; it arose when work on the contracts was terminated at the request of the United States. The suspension requests (R. 52–56) clearly terminated the produc-

December 31, 1918, of the materials, the Commissioner was not warranted in ignoring intervening events having a legitimate bearing upon the value of the materials. The payment of the sums in question to the petitioner by the United States as the cost of the materials was the very best evidence of such value available to the Commissioner. See *Producers Fuel Co.* v. *Commissioner,* 1 B. T. A. 202; *McCreery* v. *Commissioner,* 4 B. T. A. 967, 979–980; *Ewing Thomas Converting Co.* v. *McCaughn,* 43 F. (2d) 503, certiorari denied, 282 U. S. 897.

The petitioner points out that one of the agreements was not originally executed according to law and apparently argues that consequently it did not become a valid contract until made such, in effect, by the Dent Act of March 2, 1919, and contends that this agreement was not a contract "at fixed prices entered into *before the date of the inventory*" within the meaning of Article 1584. But it was made in 1918 and the Dent Act operated to validate it. The mere fact that that Act was not passed until a short time after the end of the year 1918 would not seem to be important, especially as its effective date was prior to the date fixed by law for the filing of the petitioner's return for 1918. (R. 59.)

Other contentions made by the petitioner are, we believe, in substance answered by what has already been stated. The question presented as to the valuation of petitioner's inventory is one peculiar to the instant case. It arises under the special provisions

of war contracts, is affected by peculiar circumstances affecting the particular taxpayer involved, and is not likely to be one of frequent occurrence. We do not believe that this issue involves any question of general importance or application.

CONCLUSION

We do not oppose the petition in so far as it relates to the claimed deduction for obsolescence, inasmuch as that involves a question as to the application of *Burnet* v. *Niagara Falls Brewing Co.*, 282 U. S. 648. But we suggest that the other points raised are not of sufficient importance to warrant a review by this Court.

Respectfully submitted.

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OCTOBER, 1931.

APPENDIX

STATUTES AND REGULATIONS

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1077 provides in part:

> SEC. 203. That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.
>
> * * * * *
>
> SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
>
> * * * * *
>
> (4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;
>
> * * * * *
>
> (7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence * * *.

Articles 109, 143, 161, 162 of Regulations 45 (1920 edition), promulgated under the Revenue Act of 1918, provide:

ART. 109. *Rentals.*—Where a leasehold is acquired for business purposes for a specified sum, the purchaser may take as a deduction in his return an aliquot part of such sum each year, based on the number of years the lease has to run. Taxes paid by a tenant to or for a landlord for business property are additional rent and constitute a deductible item to the tenant and taxable income to the landlord, the amount of the tax being deductible by the latter. The cost borne by a lessee in erecting buildings or making permanent improvements on ground of which he is lessee is held to be a capital investment and not deductible as a business expense. In order to return to such taxpayer his investment of capital, an annual deduction may be made from gross income of an amount equal to the total cost of such improvements divided by the number of years remaining of the term of lease; and such deduction shall be in lieu of a deduction for depreciation. If the remainder of the term of lease is greater than the probable life of the buildings erected, or of the improvement made, this deduction shall take the form of an allowance for depreciation. (See article 48.)

ART. 143. *Loss of useful value.*—When through some change in business conditions the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in the business, he may claim as a loss for the year in which he takes such action the difference between the cost or the fair market value as of March 1, 1913, of any asset so discarded (less any depreciation sustained) and its salvage value remaining. This exception to the rule requiring a sale

or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property must be prematurely discarded, as, for example, where an increase in the cost of or other change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be charged off on the books and fully explained in returns of income. But see articles 181–189.

ART. 161. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the useful life of

the property in the business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost, or its value as of March 1, 1913, if acquired by the taxpayer before that date. See further articles 839 and 844.

ART. 162. *Depreciable property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the property becoming inadequate to the growing needs of the business. It does not apply to inventories or to stock in trade; nor to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provision for this being made in the statute. See articles 201–237. Property kept in repair may, nevertheless, be the subject of a depreciation allowance. See article 103. The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. No such allowance may be made in respect of automobiles or other vehicles used chiefly for pleasure, a building used by the taxpayer solely as his residence, nor in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as

a theatrical business, may be the subject of a depreciation allowance.

Treasury Regulations 45 (1920 edition), promulgated under the 1918 Act, as amended March 3, 1922 (C. B. I–1, pp. 40–41, 42):

> ART. 1581. *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and end of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. Only merchandise title to which is vested in the taxpayer should be included in the inventory. * * *
>
> ART. 1582. *Valuation of inventories.*—The Act provides two tests to which each inventory must conform—(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order to clearly reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation, so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a gen-

eral rule, be regarded as clearly reflecting his income.

The basis of valuation most commonly used by business concerns and which meets the requirements of the Revenue Act is (*a*) cost or (*b*) cost or market, whichever is lower. (For inventories by dealers in securities, see art. 1585.) * * *

In respect to normal goods, whichever basis (*a*) or (*b*) is adopted must be applied with reasonable consistency to the entire inventory. Taxpayers were given an option to adopt the basis of either (*a*) cost or (*b*) cost or market, whichever is lower, for their 1920 inventories, and the basis adopted for that year is controlling and a change can now be made only after permission is secured from the Commissioner. * * *

* * * * *

ART. 1584. *Inventories at market.*—Under ordinary circumstances, and for normal goods in an inventory, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which usually purchased by the taxpayer, and is applicable in the cases (*a*) of goods purchased and on hand, and (*b*) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts (i. e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market exists or where quotations are nominal due to stagnant market conditions, the taxpayer must use such evidence of a fair

market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less proper allowance for selling expense, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market. It is recognized that in the latter part of 1918, by reason among other things of governmental control not having been relinquished, conditions were abnormal and in many commodities there was no such scale of trading as to establish a free market. In such a case, when a market was established during the succeeding year, a claim may be filed for any loss sustained in accordance with the provisions of section 214 (a) 12 or section 234 (a) 14 of the statute. See articles 261–268.

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tion of ammunition under the contracts and indicated the intention of the United States to take steps to settle its remaining liability under the contracts *College Point Boat Corp.* v. *United States,* 267 U. S. 12, relied upon by the petitioner, involved contracts which did not contain provisions such as those above set forth and does not seem relevant to the instant case.

It must be admitted that the question whether the goods come within the precise category mentioned in the regulations in which the court below placed them is not free from doubt, particularly as the amended regulations inserted after the words "firm sales contracts" the following:

> (i. e., those not legally subject to cancellation by either party).

But even if they do not come within that category, it would not seem to follow that the Commissioner's determination should be reversed. Article 1584 obviously was not intended to provide expressly for every situation, as is shown by the fact that it begins with the words "under ordinary circumstances," and that Article 1582 (pp. 20–21, *infra*) seems to contemplate that the Commissioner should be allowed some discretion and that the taxpayer should not be granted the absolute right to adopt the basis of "cost or market, whichever is lower," for inventories prior to the year 1920. It may well be that the regulations contain no express provision covering the unusual situation in the instant case.

If so, it was the duty of the Commissioner to determine the proper basis for determining the value of the inventory, and his decision in this case seems to be consistent with the general theory underlying the regulations. One of the fundamental tests for each inventory is that "it must clearly reflect the income" (Article 1582, p. 20, *infra*), and other provisions of the regulations seem to contemplate that goods can not be inventoried at a merely nominal value where the general market value is nominal if they are being manufactured for a solvent customer who is under obligations to pay a substantial price for them. An inventory fixing the value of goods at $231,000 would not clearly reflect the income where the goods actually cost over $700,000 and were disposed of for that figure or more.

The petitioner contends that "taxes must be determined according to what takes place in the tax year" and that the Commissioner was not warranted in adopting as the value of the materials in question the amounts paid by the United States to the petitioner as the cost thereof under the settlement contracts entered into in 1920, 1921, and 1922. The Commissioner's determination of the value of the materials, as of December 31, 1918, was not made until after the settlement contracts had been executed. The time for assessing the petitioner's taxes for 1918 had not then expired. (R. 59–60.) In determining, in 1925, the value as of

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ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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The opinion of the Court of Claims (R. 88) is reported in 71 C. Cls. 575 and also in 48 F. (2d) 983.

JURISDICTION

The judgment of the Court of Claims was entered June 10, 1931. (R. 200). The petition for a writ of certiorari was filed September 3, 1931, and granted November 23, 1931. (R. 203.) The jurisdiction of this Court rests upon Section 3 (b) of the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the petitioner, in computing its taxable income for the year 1918, was entitled to deduct, as for obsolescence, the depreciation in value of its interest in buildings, which it had erected on leased land for the purpose of manufacturing munitions of war, resulting from the termination of the business after the armistice. The facts relating to this question are stated on pp. 3–6, *infra*.

2. Whether, in computing petitioner's taxable income for the year 1918, the Commissioner erred in the valuation which he placed upon the petitioner's inventory as of December 31, 1918. This question depends upon the proper method of valuing certain material which was being manufactured for the Government. The facts relating to this question are stated on pp. 6–9, *infra*.

STATUTES AND REGULATIONS

The applicable statutes and regulations appear in the Appendix, pp. 34–45, *infra*.

STATEMENT

This suit was brought to recover alleged overpayments of the petitioner's 1918 income and profits taxes amounting to $843,589.12. The petitioner's claim was predicated upon three alleged errors of the Commissioner. (R. 15–43.) The Court of Claims sustained the contention of the petitioner as

to one of the alleged errors and entered judgment for petitioner for $160,978.83 and interest. (R. 200.) No question as to this point is here involved.

I. Facts bearing upon claim for obsolescence of buildings

Prior to 1914 the petitioner was engaged in the manufacture of ammunition for commercial purposes, its business being carried on principally in rented buildings. (R. 77.) In 1914, for the purpose of completing orders for munitions of war which it had received and expected to receive while the war continued, the petitioner began the construction of certain buildings on land of its lessor, under an agreement whereby it was to occupy such land and buildings, rent free, for ten years, at the end of which time the buildings were to become the property of the lessor. (R. 77–78.) These buildings were erected, largely in 1915 and 1916, at a cost to the petitioner of $802,499.49. (R. 78.)

When the petitioner erected the buildings it had no use for them except for war purposes. During the World War the petitioner conducted a large and profitable business in ammunition intended for use in the war, first for European Governments, and later for the United States after it entered the war, and it used the buildings during the war to their full capacity. After the armistice in 1918 the petitioner received no new orders for military ammunition and did not expect any. It had no expectation of continuing the production of mili-

tary ammunition after the war and did not do so to any material extent. (R. 78–79.)

During the remaining period of the lease, none of the buildings in question was abandoned, and most of the space in them was used in the manufacture of commercial ammunition. A small part of the space was used in the manufacture of radiators, radiator tubes, motors, paper boxes and other articles. The volume of this other business was small as compared to the petitioner's commercial ammunition business. Approximately nine-tenths of the petitioner's sales were of commercial ammunition in each of the years 1920 to 1924. The petitioner made no profit from any of its manufacturing operations in any of the years 1919 to 1924, inclusive. (R. 81, 82, 84.)

Mechanically there is no difference between the manufacture of military ammunition and the manufacture of commercial ammunition, but the same machinery will produce more military ammunition because there are fewer sizes and types of the former than of the latter. (R. 82.)

Included in the buildings in question was a garage costing $41,017.03. (R. 78.) The petitioner had erected the garage for storage and service of its trucks and automobiles used in its own business. It needed the garage only while conducting the war business. From 1919 to October, 1923, the building was operated as a public garage through a subsidiary company. An agency for the sale of auto-

mobiles was also conducted there. It was used in its entirety for these purposes. This garage business showed a loss and the petitioner realized no net return from the garage until October, 1923, when it was leased to others at a rental of $300 a month, the petitioner paying the taxes and insurance on the building. (R. 83.)

The value of the petitioner's right to use all these buildings erected by it on the leased land for the six years of its lease remaining after December 31, 1918, did not exceed $190,969.86. (R. 82.)

In petitioner's income and excess-profits taxes for the years 1914 through 1917, inclusive, the Commissioner allowed deductions totalling $197,107.74 on account of depreciation in petitioner's interest in the buildings. (R. 79.) In its return for the 1918 income and profits taxes the petitioner averred that the value on December 31, 1918, of its right to use the buildings for the remaining six years of its lease was only $190,969.86, and asserted that it was entitled to deduct from its gross income of 1918 the difference between the depreciated value of the buildings at the beginning of 1918 (i. e., the cost, less depreciation to December 31, 1917) and the residual value of the lease, $190,969.86, at the end of 1918. The deduction so claimed amounted to $414,421.89. (R. 79–80.) The Commissioner rejected the claim and allowed a deduction of $86,484.54 for depreciation of petitioner's interest in the buildings. The amount of the latter allowance,